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May 16, 1996

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Office of the Secretary  
Federal Communications Commission  
1919 M Street N.W., Room 222  
Washington, D.C. 20554

Regarding: *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket 96-98.*

Dear Secretary:

Enclosed please find the original and sixteen (16) copies of the Comments of the Attorney General of the Commonwealth of Massachusetts in the above referenced case.

Thank you for your attention to this formal filing. If you have any questions please do not hesitate to call.

Sincerely,

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*Daniel Mitchell*

Daniel Mitchell  
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Before  
**THE FEDERAL COMMUNICATIONS COMMISSION**  
Washington, D.C. 20554

\_\_\_\_\_  
In the Matter of )  
Implementation of the Local Competition ) CC Docket No. 96-98  
Provisions in the Telecommunications Act of 1996 )  
\_\_\_\_\_)

**COMMENTS  
OF THE  
ATTORNEY GENERAL  
OF THE COMMONWEALTH OF MASSACHUSETTS  
ON THE COMMISSIONS' NOTICE OF PROPOSED RULEMAKING  
TO IMPLEMENT SECTIONS 251, 252, AND 253 OF THE  
TELECOMMUNICATIONS ACT OF 1996**

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Respectfully submitted,

**SCOTT HARSHBARGER  
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## EXECUTIVE SUMMARY

The Federal Communications Commission ("Commission" or "FCC") has the authority to adopt national pricing rules and regulations to ensure the rates established by the States for essential inputs - interconnection, unbundled elements, and collocation - are just, reasonable, nondiscriminatory, and comply with the Telecommunications Act of 1996 ("Act"). In an effort to assist the FCC in establishing national pricing principles, the Attorney General of the Commonwealth of Massachusetts ("Attorney General" or "MassAG") recommends that the FCC adopt total service long-run incremental cost, plus a markup for product-specific economic overheads and a reasonable profit, ("TSLRICplus") for setting incumbent local exchange carrier ("ILEC") prices for essential inputs sold to non-incumbent competing local exchange carriers ("CLECs").

The Attorney General's TSLRICplus proposal ensures that the job of carrying intraLATA traffic does in fact go to the most efficient carrier. TSLRICplus, with its markup for product-specific economic overhead costs and a reasonable return on investment, satisfies ILEC concerns that their prices for essential inputs sold to competitors will cover their economic general overhead expenses and earn a reasonable profit. In addition, TSLRICplus proposal eliminates CLEC concerns that ILEC prices for essential inputs will include monopoly rents (i.e., uneconomic costs and excessive profits). Most importantly, TSLRICplus meets all the pricing requirements in section 252(d)(1) of the Act, because it is not based on a prior rate-of-return or rate-based proceeding. TSLRICplus provides a non-rate-of-return and a non-rate-based cost of a service, plus a markup for economic overhead costs and a reasonable profit. The

Attorney General's proposal, thus, bridges the vast gap between ILECs and CLECs on the issue of pricing essential inputs, and provides ILECs and CLECs alike the most realistic form of pricing in a regulated competitive marketplace. For these reasons, the MassAG urges the FCC to adopt TSLRICplus as the national standard and long-term goal for setting ILEC prices for essential inputs.

In addition, the MassAG recommends that the Commission adopt Attorney General's proposed flat-rate capacity-based compensation plan as the national reciprocal compensation plan for the transport and termination of local exchange and intraLATA traffic. The Attorney General's TSLRICplus capacity-based compensation rate would keep transport and termination costs at or near the market based, economically efficient level for transporting and terminating local and intraLATA toll calls. Uneconomic contribution would be excluded from the rate calculation. The Attorney General's proposed flat-rate capacity-based charge would allow CLECs to innovatively package new services and provide time of day discounts, therefore, increasing the incentive to expand the number of both their business and residential customers. Moreover, a flat-rate system will allow CLECs to provide a flat-rate local service to residential customers in Massachusetts that can compete with NYNEX's flat-rate local service. A flat rate calling environment necessitates a flat-rate calling compensation arrangement. Otherwise, CLECs will incur additional costs to serve residential customers through a per-minutes-of-use interconnection charge without the benefit of additional revenue, thus weakening the competition in the flat-rate residential local exchange market. The Attorney General's national reciprocal compensation proposal will stimulate meaningful local

competition which will result in higher quality services at lower prices sooner rather than later.

Lastly, the Commission should require ILECs to provide, in the interim, like-for-like resale of all of their services at 25 percent off retail prices until TSLRICplus avoidable costs studies are completed and approved. The Attorney General's proposed interim discount is based RBOC ARMIS data which demonstrates that ILECs would avoid 25 percent of its cost by offering local unlimited services for resale on a wholesale basis. Under the Attorney General's long-term TSLRICplus resale proposal, ILECs would be required to perform TSLRICplus avoidable cost studies for determining wholesale rates based on the avoidable costs of retail rates sold to subscribers, which includes a share of general economic overhead costs or "markup" assigned to such costs, should be adopted. ILECs would then reduce their retail rates by this TSLRIC avoidable cost amount, offset by any portion of those expenses that ILECs incur in the provision of their wholesale services. The Attorney General's proposal is consistent with section 252(d)(3), because it specifically focuses on marketing, billing, collection, and other costs that ILECs will avoid when selling retail services on a wholesale basis to CLECs. Therefore the proposal, eliminates the possibility of CLECs being charged monopoly rents in the wholesale prices ILECs charge for the resale of their services, and it assures that the cost ILECs incur in the provision of wholesale services to CLECs is included in the prices for these services. ILEC wholesale prices for retail services based on TSLRICplus will be just, reasonable, nondiscriminatory, in compliance with the Act, and promote competition and its resulting consumer benefits.



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**I. Introduction.**

The Attorney General represents consumer interests in telephone cases before the Massachusetts Department of Public Utilities, and also enforces consumer protection and antitrust laws.<sup>1</sup> The Attorney General's specific interest in the Commission's Notice of Proposed Rulemaking ("NPRM") is to comment on the pricing principles regarding rates for interconnection, unbundled network elements, wholesale services, and reciprocal compensation arrangements. The purpose of the Commission's NPRM is to seek comment on the proposed implementation of a national framework for enhancing competition, increasing consumer choice, lowering rates, and reducing regulation. The Commission tentatively concluded that it should establish pricing principles to ensure that rates established by the States for interconnection, unbundled elements, and

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<sup>1</sup> Massachusetts General Laws Chapter 12, Section 11E.

collocation comply with the Telecommunications Act of 1996, and are just, reasonable, and nondiscriminatory. Consequently, the Attorney General respectfully submits his comments on pricing principles in effort to assist the Commission in establishing national pricing principles to promote competition and to ensure that the rates established in Massachusetts, and the other forty-nine states, are just, reasonable, nondiscriminatory, and comply with the Act.

**II. The FCC Has The Statutory Authority To Adopt Pricing Rules And Regulations Based On Total Service Long-Run Incremental Cost, Plus A Markup For Economic Overheads And A Reasonable Profit, To Ensure ILEC Prices For Interconnection, Unbundled Elements, And Collocation Are Just, Reasonable, And Nondiscriminatory. Comments on ¶117 of the NPRM.**

The Commission has the statutory authority to adopt pricing rules and regulations to ensure the rates for interconnection, unbundled elements, and collocation are just, reasonable, and nondiscriminatory. Congress adopted a new model of interconnection which incorporates provisions from both the Senate bill and the House amendment in section 251.<sup>2</sup> The Conference report explicitly states that "section 251(d) requires the Commission to adopt regulations to implement new section 251 within 6 months". *Explanatory Statement*, p. 122. Therefore, the Commission has the authority to adopt pricing rules, regulations, and methodologies for the pricing subsections of section 251, which include:

- a. Subsection 251(c)(2)(D), which requires that telecommunications carriers provide interconnection on rates, terms, and conditions that are just, reasonable, and nondiscriminatory;

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<sup>2</sup> See, Joint Explanatory Statement of the Committee of Conference, Conference Report No. 104-458 ("*Explanatory Statement*"), p. 121 (Jan. 31, 1996).

- b. Subsection 251(c)(3), which requires that telecommunications carriers provide nondiscriminatory access to network elements on an unbundled basis on rates, terms and conditions that are just, reasonable, and nondiscriminatory;
- c. Subsection 251(c)(6), which requires that telecommunications carriers provide physical collocation of equipment on rates, terms and conditions that are just, reasonable, and nondiscriminatory; and
- d. Subsection 252(d)(1), which states for purposes of setting just and reasonable rates for the interconnection of equipment and facilities under section 251(c)(2), and for the purpose of just and reasonable rates for network elements under section 251(c)(3), rates shall be based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of the providing interconnection or network elements, and may include a reasonable profit.

The Attorney General shares the Commission's commitment to the goal of opening telecommunications markets to competition and accelerating the rapid deployment of advanced telecommunications services and information technologies to all Americans.<sup>3</sup> Therefore, one of the most important issues in this Rulemaking is to establish economically efficient prices for interconnection, network elements, and physical collocation. The proper setting of these prices will "ensure that the job of carrying intraLATA traffic will go to the most efficient carriers." *NYNEX's Massachusetts Petition for Price Cap Regulation, ("Price Caps Case")*, docket no. DPU 94-50, note 147 (1995). To ensure that the most efficient carriers carry intraLATA traffic, the Attorney

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FCC's Notice of Proposed Rulemaking ("NPRM"), CC Docket No. 96-98, ¶125, p. 11 (April 19, 1996).

General recommends that the Commission set ILECs prices for essential inputs<sup>4</sup> - interconnection, network elements, and physical collocation at - total service long-run incremental cost plus a limited markup/contribution for product-specific economic overhead costs and a reasonable profit - TSLRICplus. TSLRICplus pricing will ensure that the job of carrying intraLATA traffic does in fact go to the most efficient carriers.

CLECs cannot get into local exchange markets without buying certain services or network elements from ILECs. If an ILEC charges competitors too much, CLECs will be unable to compete. The level of markup for product-specific economic overhead costs that the Commission allows ILECs to include in their essential inputs sold to CLECs will determine whether CLECs can afford to purchase essential inputs and enter local exchange markets. As the Rochester Telephone Company experiment proves, if wholesale prices to competitors are too high, CLECs will be priced out of the local exchange market.<sup>5</sup> The Rochester lesson must not be forgotten. The FCC must seriously consider any level of contribution included in ILEC prices for essential inputs,

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<sup>4</sup> For example, a link/unbundled loop is an unbundled network element which represents the line that connects the end user's premises to the local end office for the purpose of gaining dial-tone and, thereby, access to the switched services such as local, intraLATA and interstate toll.

<sup>5</sup> In Rochester, ten CLECs originally expressed interest to enter the local Rochester market through the resale of Rochester Telephone Company's local exchange services at 5 percent off retail. *See, Testimony of William D. Salvatore, Eastern Region District Manager for AT&T Communications, Inc.*, before the Massachusetts Department of Public Utilities, Docket 94-185, Transcript Volume 6 ("*Tr. Vol. 6*") pp. 111-112 (July 13, 1995). Only AT&T, however, actually did enter the market and attempted to resell Rochester's local services for profit. *Id.* Unfortunately, once in the market, and despite AT&T's best efforts, it is currently losing money on every one of its resale customers. *Id.* AT&T is now considering pulling out of the market. *Id.*

because if the of level the markup is too high, economically efficient CLECs will never get a fair opportunity to compete in local exchange markets, and consumers will never reap the benefits of local exchange competition.

**III. The FCC Should Adopt TSLRICplus As The Appropriate National Standard For A Long-Term Method For Pricing ILECs Network Elements Sold To Competitors. Comments on ¶131 of the NPRM.**

The MassAG's TSLRICplus proposal establishes a realistic goal of setting ILEC prices for network elements/essential inputs at levels which would most closely resemble a truly competitive marketplace where prices would be set at their most economically efficient levels based on competitive forces - second-best efficient pricing.<sup>6</sup> TSLRICplus provides the most realistic attempt at setting economically efficient prices in the local exchange market, both in the static<sup>7</sup> and dynamic<sup>8</sup> sense. Indeed, experts agree that first-best efficient pricing<sup>9</sup> is unrealistic in a truly competitive market because the firm would

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<sup>6</sup> Under second-best efficient pricing, prices are set at levels that allow efficient companies to recover their economic common costs. Second-best efficient prices means pricing services at incremental cost plus contribution to recover current and forward-looking fixed costs. Second-best efficient pricing does not include markups to recover historic or sunk costs, the non-economic costs included in the provision of services. See, *Testimony of Dr. Alfred E. Kahn*, before the Massachusetts Department of Public Utilities, Docket No. 94-185, Tr. Vol. 15, pp. 85-93 (Oct. 3, 1995).

<sup>7</sup> Static efficiency means minimizing the additional marginal cost or incremental cost of supplying the service(s).

<sup>8</sup> Dynamic efficiency refers to the improvement of an economy or a company over time through the achievement of the optimum rate of improvement in productive efficiency - cost reduction over time - and through the offering of new innovative services and products.

<sup>9</sup> First-best efficient pricing means pricing services at the minimal achievable marginal cost, because this would waste the least amount of society's resources. There

not to recover all of its economic overhead costs. Moreover, experts agree that third-best efficient pricing would not last in a truly competitive market because the market would force out all uneconomic costs included in the prices of services sold to consumers and competitors.<sup>10</sup> Consequently, the Attorney General's TSLRICplus proposal represents a practical and desirable long-term pricing goal for the Commission.

**A. The ECPR Or Equivalent Methodologies For Setting Prices For Interconnection And Unbundled Network Elements Would Be Inconsistent With Section 252(d)(1) Of The Act. Comments on ¶¶ 147 and 148 of the NPRM.**

ILECs have proposed in various state jurisdictions the application of the theory of competitive parity, or the efficient component pricing rule ("ECPR"), for setting network element, interconnection and physical collocation prices, and the level of contribution in these prices. The ECPR first assumes that no supplier would sell an essential input to a competitor for less than the incremental cost of the input, including the contribution that the supplier would lose if a competitor bought the input and sold the product in the

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would be no level of contribution in the price for services. *See, Testimony of Dr. Alfred E. Kahn*, before the Massachusetts Department of Public Utilities, Docket No. 94-185, Tr. Vol. 15, pp. 85 (Oct. 3, 1995). However, first-best efficient pricing is essentially non-existent in the real world because prices which are "set at marginal costs alone would not yield a return in the aggregate of a firm's operations equivalent to the cost of capital." *Id.*, pp. 11-12. Therefore, firms in a fully competitive world must mark up some prices above marginal cost if the firm is to achieve its cost of capital. *Id.*

<sup>10</sup> In this context, third-best efficient pricing means pricing services at incremental cost and adding a markup to include the total revenue requirement of the ILEC, including economic and non-economic costs. The Application of the ECPR pricing methodology results in third-best efficient pricing. *See, Testimony of Dr. Alfred E. Kahn*, before the Massachusetts Department of Public Utilities, Docket No. 94-185, Tr. Vol. 15, pp. 85 (Oct. 3, 1995).

retail market.<sup>11</sup> Second, the ECPR assumes no supplier would sell the finished product in the retail market for less than the incremental cost of the product including the contribution that the supplier could have made from selling its inputs to a competitor. Thus, the retail price is equal to the sum of the incremental cost and the contribution foregone by selling the component in the retail rather than the wholesale market.<sup>12</sup> *Id.*, pp. 10-11.

The ECPR is inconsistent with the Act, because it is based on past rate-of-return and rate-based proceedings, and section 252(d)(1) of the Act states that just and reasonable rates for interconnection of facilities and equipment must be "based on cost (determined *without reference* to rate-of-return or other rate-based proceeding)." Therefore, the application of the ECPR would preserve an ILEC's fully allocated revenue requirement indefinitely in an ILEC's retail prices charged to ratepayers and in its wholesale prices charged to CLECs for essential elements. ILECs' proposed level of contribution would include more than the recovery of economic joint and common costs

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<sup>11</sup> See, *Prefiled Testimony of Dr. William E. Taylor*, before the Massachusetts Department of Public Utilities, docket 94-185, pp. 9-10 (May 19, 1995).

<sup>12</sup> Under the ECPR, ILEC prices for local termination would equal the average retail price of intraLATA toll service minus the incremental cost of the retail toll function (advertising, billing and collection, customer service. etc.) and the cost of providing access to a competitor and of supplying it as a component of an integrated toll service. See, *Prefiled Testimony of Dr. William E. Taylor*, before the Massachusetts Department of Public Utilities, docket 94-185, p. 18 (May 19, 1995). Under this application, the price of the link - the wholesale price of dial tone - is equal to the incremental cost of the link plus the retail contribution (from all services) that is lost when a competitor takes a subscriber away. *Id.* at 19. Foregone contribution would include the contribution from (1) dial tone; (2) carrier access services; (3) local usage; (4) custom calling services and possibly contribution from intraLATA toll. *Id.*

and a reasonable return on investment, but also any monopoly rents included in its current revenue requirement.<sup>13</sup> Since an ILEC's wholesale prices charged to CLECs for links and local access include a level of contribution sufficient to maintain an ILEC's entire current revenue requirement, retail rates to end users would remain uneconomically high under the ECPR. The ECPR would, by heavily loading "contribution" into wholesale prices, require ratepayers and CLECs to ensure an ILEC's current revenue requirement and its profits even in a competitive local exchange market. Under the ECPR proposed regime, ratepayers and CLECs face the very real possibility that local exchange competition would not lead to lower prices or accelerated offerings of new and innovative services to local exchange markets.

The ECPR does nothing to avoid the possibility of charging CLECs uneconomically high prices for essential inputs. ILECs proposed prices would in all likelihood be too high and consequently prohibit or significantly restrain CLEC entry into local exchange markets. If CLECs are forced to subsidize ILECs uneconomic costs and excess profits, few if any competitors will enter the local exchange markets. CLECs should not be required to fund either ILECs' excess profits or uneconomic costs. In a truly competitive market, ILECs would be unable to sustain their uneconomic costs or

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<sup>13</sup> There are two types of monopoly rents: (1) inefficiencies in the provision of a service giving rise to higher costs; and (2) any profits in excess of what would represent a reasonable return on investment. *Testimony of Dr. Nina W. Cornell*, before the Massachusetts Department of Public Utilities, docket 94-185, Tr. Vol. 14, pp. 75-79, and 138-139 (Oct. 2, 1995). In a fully competitive market monopoly rents would not persist. Drs. William Baumol & Gregory Sidak, *The Pricing of Essential Inputs Sold to Competitors*, 11 Yale Journal on Regulation, pp. 195-196 (Winter 1994).



excess profits.<sup>14</sup>

**B. TSLRICplus Is The Preferred Long-term National Pricing Methodology  
And Is Consistent With Section 252(d)(1) of the Act. Comments on ¶¶131  
and 132 of the NPRM.**

In contrast to the ECPR proposal, most CLECs recommend various applications of long-term incremental cost ("LRIC") or total service long-run incremental cost ("TSLRIC") for determining the prices for essential inputs sold by ILECs to competitors or for setting price floors for particular services to safeguard against cross-subsidization.<sup>15</sup> TSLRIC of a service is specifically defined as the firm's total forward looking costs of producing all its services, using the least cost technology for producing that full array of services, minus the firm's total forward looking costs of producing all of its services except the service under the study, using the least cost technology for producing the

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<sup>14</sup> See, Drs. William Baumol & Gregory Sidak, *The Pricing of Essential Inputs Sold to Competitors*, 11 Yale Journal on Regulation, pp. 195-196 (Winter 1994).

<sup>15</sup> Marginal cost is the change in the total cost to the firm caused by one infinitesimal change in quantity. See, *Testimony of Dr. Nina W. Cornell*, before the Massachusetts Department of Public Utilities, docket 94-185, Tr. Vol. 14, p. 55 (Oct. 2, 1995). Long-run incremental cost is the change in the total cost of the firm caused by a measurable increment in output, (e.g., a 20 percent increase in quantity of the service), measured over a long enough time period for the firm to reoptimize all of its plant and equipment to accommodate the change in output. See, *Testimony of Dr. William E. Taylor*, before the Massachusetts Department of Public Utilities, docket 94-185, Tr. Vol. 17, pp. 8-9 (Oct. 6, 1995); *Testimony of Dr. Nina W. Cornell*, before the Massachusetts Department of Public Utilities, docket 94-185, Tr. Vol. 14, pp. 55-56 (Oct. 2, 1995). Total service long-run incremental cost is the change in the total cost of the firm caused by the change in the increment, here the increment is the total quantity of the service being provided, considered over a long enough time period so the firm can reoptimize its plant and equipment to accommodate the change. *Id.*

array that excludes the service under the study.<sup>16</sup> CLECs argue that - given the changes in technology over the last ten years, the importance of cost-based pricing for monopoly services as the local exchange market is opened to competition, and the now vintage ILECs' cost analyses - there needs to be updated cost studies to align prices for network elements at economically efficient prices.

However, strictly applying TSLRIC to set prices for an essential inputs would not allow ILECs' recovery of their total economic costs associated with providing essential inputs to competitors. TSLRIC does not include all shared costs, because by definition, it does not include any general corporate shared costs such as overheads.<sup>17</sup> As the Massachusetts Department of Public Utilities noted in its Price Caps Order, "the cost

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<sup>16</sup> The Attorney General disagrees with the argument that LRIC is the proper application for pricing essential inputs. Dr. Gerald A. Hausman testifying on behalf of Cellular One before the Massachusetts Department of Public Utilities, claimed that the key question in pricing essential inputs is how much will it cost NYNEX to provide more access service. *Testimony of Dr. Gerald A. Hausman*, before the Massachusetts Department of Public Utilities, Tr. Vol. 13, pp. 18-19 (Sept. 29, 1995). On the contrary, what this Massachusetts proceeding attempted to establish was the prices for three new services: links, local access termination, and resale of unlimited services. These are three new services that NYNEX-Massachusetts has never offered before. Therefore, the question is not how much will it cost NYNEX to provide more access, as in switched access, but rather what will it cost NYNEX to provide the three new services. The Commission must, therefore, determine the incremental cost to ILECs for providing each of these new services over a long enough period of time for ILECs to reoptimize its plant and equipment. *Testimony of Dr. William E. Taylor*, before the Massachusetts Department of Public Utilities, Tr. Vol. 17, pp. 8-9 (Oct. 6, 1995); *Testimony of Dr. Nina W. Cornell*, before the Massachusetts Department of Public Utilities, Tr. Vol. 14, pp. 55-56, (Oct. 2, 1995). By definition, the Commission will be attempting to apply TSLRIC to establish the prices for new services.

<sup>17</sup> *Prefiled Testimony of Charles B. Goldfarb, Executive Staff Member, Regulatory and Policy Analysis, MCI Telecommunications Corp.*, before the Massachusetts Department of Public Utilities, docket 94-185, p. 13 (May 19, 1995).

structure for telecommunications is such that the firm's total costs are not recovered when prices are set at marginal cost." *Price Caps Order*, DPU 94-50, p. 249, note 144. The same is true when prices are set at TSLRIC.<sup>18</sup> Consequently, the CLECs' strict application of TSLRIC would prevent ILECs from recovering their total economic costs incurred when selling essential inputs sold to competitors.

In sum, ILECs want too much contribution, effectively charging CLECs monopoly rents which may price many economically efficient CLECs out of the local exchange market. In contrast, CLECs ignore ILECs' economic costs associated with selling competitors essential inputs which may allow less-efficient CLECs to enter local exchange market at a cost to ILECs. Adoption of either proposal would be harmful to the development of economically efficient competition in the local exchange markets. Consequently, the Commission must set standards that bridge the gap between these two very extreme positions if meaningful competition is ever to develop in local exchange markets.

The Attorney General's TSLRICplus proposal addresses both ILEC and CLEC concerns regarding the level of contribution included in essential input prices. First, TSLRICplus, with its markup for product-specific economic overhead costs and a reasonable return on investment, satisfies ILEC concerns that their prices for essential inputs sold to competitors will cover their general overhead expenses and earn a

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<sup>18</sup> *Prefiled Testimony of Charles B. Goldfarb, Executive Staff Member, Regulatory and Policy Analysis, MCI Telecommunications Corp.*, before the Massachusetts Department of Public Utilities, docket 94-185, p. 13 (May 19, 1995).

reasonable profit. Second, TSLRICplus also satisfies CLEC concerns, because CLECs will not be charged monopoly rents in the prices ILECs charge CLECs for essential inputs. Most importantly, TSLRICplus is consistent with section 252(d)(1), because it is not based on a prior rate-of-return or rate-based proceeding. TSLRICplus provides a non-rate-of-return or non-rate-based cost of a service, plus a markup for economic overhead costs and a reasonable profit. Therefore, TSLRICplus meets all the pricing requirements in section 252(d)(1). The Attorney General's proposal, thus, bridges the vast gap between ILECs and CLECs on the issue of pricing essential inputs, and provides ILECs and CLECs alike the most realistic form of pricing in a regulated competitive marketplace. For the reasons stated above, the Attorney General urges the Commission to adopt TSLRICplus as the national standard and long-term goal for setting ILEC prices for essential inputs.

**IV. The Massachusetts Attorney General's Proposed Reciprocal Compensation Plan For The Transport And Termination of Local And IntraLATA Toll Traffic.  
Comments on ¶¶ 150-154 and 226-244 of the NPRM.**

**A. Introduction.**

During the development of local competition, ILECs and CLECs will need to compensate one another for the exchange of traffic. In the early stages of the development of competition, ILECs will terminate (and receive compensation for) far more calls originated from alternative providers than it will deliver and pay to alternative providers to complete on their systems. Even if the per call or per minute interconnection rates are equal and reciprocal in their application, CLECs will pay ILECs far more than they receive from ILECs for terminating ILEC calls.

Facilities-based CLECs want to have the option to interconnect at every ILEC end office and tandem office, for the purpose of minimizing or eliminating transportation costs, where they determine it is economically feasible to do so. These CLECs argue that expanded interconnection tariffs and the "access charge model" are not appropriate for interconnecting facilities-based local exchange carriers.<sup>19</sup> Under the access charge model, ILECs are compensated both for interexchange carrier ("IXC") traffic that originates on its network as well as for traffic that it terminates on its network. However, with respect to ILECs, there is no intermediate CLEC or IXC involved, and a more reciprocal arrangement is warranted. The point at which the facilities-based local carriers connect their respective networks is generally referred to as the meet point. In principal, neither ILECs nor their facilities-based competitors should assess a charge to the other for the physical arrangement at the meet point. Rather, each party should bear the expense of the physical interconnection and the cost of modifying the switch to accommodate the connection.<sup>20</sup> The reciprocal compensation method adopted by the Commission in this proceeding will, to a significant degree, determine the effectiveness of local exchange competition. Compensation rates must be just, reasonable, and nondiscriminatory in order for meaningful local exchange competition to take place in

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<sup>19</sup> The access charge model refers to the ILECs intrastate and interstate switched access tariffs which set forth the rates, terms, and conditions by which interexchange carriers compensate the ILECs for traffic that originates and/or terminates on ILECs' networks.

<sup>20</sup> This is in contrast with NYNEX's expanded interconnection tariffs in Massachusetts, whereby NYNEX charges end users, carriers, and competitive access providers for various elements of collocation (e.g., office space, electricity, etc.).

local exchange markets.

**B. The FCC Should Adopt The Massachusetts Attorney General's Proposed Flat-Rate Capacity-Based Compensation Plan As The National Reciprocal Compensation Plan For The Transport And Termination Of Local And IntraLATA Toll Traffic. Comments on ¶¶ 151-154, and 226-244 of the NPRM.**

The MassAG recommends, on an interim basis, that the Commission adopt the bill and keep compensation method for the transfer and termination of traffic between ILECs and CLECs.<sup>21</sup> For the long-term, however, the MassAG recommends that when traffic balances are not in balance and exceed plus or minus 5 percent, a TSLRICplus capacity-based reciprocal compensation flat-rate charge be applied. As part of an ILEC's TSLRIC cost studies, the cost of local transport and termination should be based on TSLRIC plus a markup for product-specific economic shared and common costs with a reasonable return on investment. The Attorney General's capacity-based flat-rate reciprocal compensation charge would be based on port charges, measured at the peak busy hour of the month to determine the relevant traffic flow over the ILEC/CLEC network. Port charges would be allocated in accordance with the peak busy hour measurements. Once the TSLRICplus cost studies have been completed and approved, the monthly capacity-based flat-rate charges would be based on a the per-minute-TSLRICplus-use rate multiplied by 140,000 minutes per month (the standard traffic

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<sup>21</sup> Because transport and termination of calls are codependent, the Attorney General recommends that the FCC apply one price for local access transport and termination for purposes of the Rulemaking.

amount that a CLEC/ILEC can transport and terminate through a DS1 switch port).<sup>22</sup>

During each month, ILECs and CLECs will measure the peak busy hour of the month to determine the relevant traffic flow over the ILEC/CLEC network. For example, if the peak busy hour measurement for a given month determines that 70 percent of the traffic over the ILEC/CLEC network originates from the CLEC and 30 percent of the traffic originates from and ILEC, then the CLEC would pay the ILEC 70 percent of the port charge and the ILEC would pay the CLEC 30 percent of the port charge for that given month. By monitoring the peak busy hour measurements, ILECs and CLECs can also determine when traffic is reasonably balanced and then transition to a bill and keep arrangement.

The Attorney General's TSLRICplus capacity-based compensation rate would keep transport and termination costs at or near the market based, economically efficient level for terminating local calls. Uneconomic contribution would be excluded from the rate calculation. If uneconomic contribution were to become part of the capacity-based rate, then compensation rates would become part of an irreducible cost floor for local exchange service that would eventually come out of the pockets of ratepayers. By including ILECs' "uneconomic contribution" of shared and common costs in interconnection charges, consumers would be denied the full benefits of local

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<sup>22</sup> On October 11, 1995, before the Massachusetts Department of Public Utilities, in docket 94-185, Mr. Paul Kourouopas, Regional Director of Regulatory Affairs, Eastern Region, testified on behalf of Teleport Communications-Boston that the standard traffic amount that a CLEC can terminate through a DS1 switch port is 140,000 minutes per month. *See*, Tr. Vol. 19, p. 33.

competition, because the full benefits of competition would only result if all of ILECs' costs are subject to market pressures for greater efficiency.

The Attorney General's proposed flat-rate capacity-based charge would allow CLECs to innovatively package new services and provide time of day discounts, therefore, increasing the incentive to expand the number of both their business and residential customers. Moreover, a flat-rate system will allow CLECs to provide a flat-rate local service to residential customers in Massachusetts that can compete with NYNEX's flat rate local service. A flat rate calling environment necessitates a flat rate calling compensation arrangement. Otherwise, CLECs will incur additional costs to serve residential customers through a per-minutes-of-use interconnection charge without the benefit of additional revenue, thus weakening the competition in the flat rate residential local exchange market.

As the interim federal access capacity-based compensation plan demonstrated, capacity-based compensation creates incentives for carriers to increase their residential customer base because residential calls are primarily off peak and impose little or no cost on the network.<sup>23</sup> Once the federal per-minute-of-use access charge plan was implemented, the IXCs found business traffic more profitable than residential traffic, because per-minutes-of-use access charges made it expensive to serve off peak residential

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<sup>23</sup> See, *Prefiled Testimony of Dr. Gerald W. Brock*, on behalf of Teleport Communications-Boston, before the Massachusetts Department of Public Utilities, docket 94-185, pp. 11-13 (May 19, 1995).



customers. *Id.* IXC's paid the same rate per minute to LEC's, regardless of the time of day. Discounts for residential night calls became unprofitable. IXC's were forced to raise their prices for residential night calls because of the artificial per-minute-of-use access charge structure, even though these calls imposed practically no cost on either the LEC's or IXC's. *Id.* Minutes-of-use local access compensation charges would incorrectly signal investors that night calls are as expensive as day time calls, when they are in fact not. *Id.* This pricing methodology would distort both business and consumer decisions away from maximum economic efficiency. The Attorney General does not want to see CLEC's or ILEC's lose any incentive to service residential customers. *Id.* The Attorney General's capacity-based local access charge proposal provides ILEC's and CLEC's with the proper incentives to service residential customers in competitive local exchange markets. *Id.*

If the Commission adopts a per-minutes of-use compensation method, then the CLEC's, like the IXC's under the federal per-minutes-of-use access compensation plan, will find business traffic more profitable than residential traffic. *Id.* Thus, the CLEC's and ILEC's will more aggressively pursue business customers rather than residential customers. The incentives created by the minutes-of-use access charges would distort marketing and investment decisions away from the efficient path and residential customers. The Attorney General urges the Commission not to adopt a per-minutes-of-use compensation method, because it would take the incentives away from ILEC's and CLEC's to aggressively pursue residential customers in competitive local exchange markets.